STATE OF MICHIGAN

IN THE SUPREME COURT

BANK OF AMERICA, N.A.,

Plaintiff-Appellant,

v

FIRST AMERICAN TITLE INSURANCE COMPANY, PATRIOT TITLE AGENCY, KIRK D. SCHIEB, WESTMINSTER ABSTRACT COMPANY, WESTMINSTER TITLE AGENCY, INC., PRIME FINANCIAL GROUP, INC., VALENTINO M. TRABUCCHI, PAMELA S. NOTTURNO, f/k/a PAMELA S. SIIRA, DOUGLAS K. SMITH, JOSHUA J. GRIGGS, STATE VALUE APPRAISALS, LLC, NATHAN B. HOGAN, and CHRISTINE D. MAYS,

Defendants-Appellees

and

FRED MATSON, MICHAEL LYNETT, JO KAY JAMES, and PAUL SMITH

Defendants.

_______________________________________/

Supreme Court No. 149599

Court of Appeals No. 307756

Oakland County Circuit Court
No. 2010-112606-CK

Hon. Denise Langford Morris

Gaëtan Gerville-Réache (P68718)
Rodney D. Martin (P32071)
WARNER NORCROSS & JUDD LLP
900 Fifth Third Center
111 Lyon Street, N.W.
Grand Rapids, Michigan 49503-2487
616.752.2000
greache@wnj.com

Attorneys for Amicus Curiae *Michigan Bankers Association*

AMICUS CURIAE BRIEF OF THE MICHIGAN BANKERS ASSOCIATION

Richard J. Landau (P42223)
Christopher A. Merrit (P70924)
RJ LANDAU PARTNERS PLLC
5340 Plymouth Road, Suite 200
Ann Arbor, Michigan 48105-9341
734.865.1585
rjlandau@rjlps.com
Attorneys for Plaintiff-Appellant

Steven M. Ribiat (P45161)
BROOKS WILKINS SHARKEY &
TURCO PLLC
401 S. Old Woodward Avenue, Suite 400
Birmingham, Michigan 48009-6613
248.971.1718
ribiat@bwst-law.com
Attorneys for Appellee First American Title Insurance Company

John R. Monnich (P23793)
OTTENWESS TAWEEL & SCHENK PLC
535 Griswold Street, Suite 850
Detroit, Michigan 48226-3671
313.965.2121
jmonnich@ottenwesslaw.com
Attorneys for Appellee Westminster Abstract Company

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STATEMENT OF INTEREST

Amicus Curiae the Michigan Bankers Association (the "MBA") is the premier trade organization for Michigan's banking industry. The MBA, founded in 1887, is a nonprofit trade association serving Michigan's banks. The MBA's members have more than 3,000 branches located throughout the state and have combined assets of more than $200 billion.

The MBA strives to advance a positive business environment for the Michigan banking industry and to foster safe, profitable, and successful banks, which in turn promote strong communities and a vibrant Michigan economy. The MBA's members are vital providers of mortgages to Michigan's citizens, allowing homeowners and businesses alike to realize their goals.

The MBA has a strong interest in the outcome of two of the four issues presented in this case: (1) whether a title insurer's closing protection letter to the mortgagee modifies the mortgagee's closing instructions to the closing agent, and (2) whether a mortgagee's purchase of the mortgaged property at the foreclosure sale per se eviscerates any claim for fraud or breach in the loan origination. The lower court's rulings on these issues are troubling to the banking industry because they inject uncertainty into the lending process, interfere with the parties' freedom of contract, and bar what normally might be valid claims for fraud or breach of contract.

STATEMENT OF QUESTIONS PRESENTED

1. Do the lender's closing instructions constitute a separate contract between the lender and the closing agent, outside of the closing protection letters?

   The trial court did not answer.

   The Court of Appeals answered: No, with a dissent.

   Defendant Westminster answers: No.

   First American did not answer.

   Bank of America answers: Yes.

   Amicus Curiae MBA answers: Yes.

2. Is the full credit bid rule of *New Freedom Mortgage Corp v Globe Mortgage Corp*, 281 Mich App 63; 761 NW2d 832 (2008), a correct rule of law and does it apply to this case?

   The trial court did not answer.

   The Court of Appeals answered: Yes.

   Defendant Westminster answers: Yes.

   First American answers: Yes

   Bank of America answers: No.

   Amicus Curiae MBA answers: No.

INTRODUCTION

At its core, this case turns on centuries-old common-law principles of contract and tort, principles that the Court of Appeals failed to consider and apply.

First, the Court of Appeals neglected to apply basic contract theory when it held that First American's closing protection letter to Bank of America modified Bank of America's closing instructions to Westminster. At common law, a contract may not be modified without the assent of both parties to the original contract. There is no dispute that the closing instructions are a contract between Bank of America and Westminster, and there is no evidence that Bank of America assented to modify those instructions. Accordingly, the Court of Appeals had no legal basis for limiting Westminster's contractual liability to only those losses First American agreed to indemnify.

The Court of Appeals also abandoned traditional damages law when it held that a mortgagee's "full credit" purchase of the mortgaged property in a foreclosure sale "bars" any claim the mortgagee may have for fraud or breach during the loan origination. The longstanding "full credit bid" rule is not a legal "bar"; it is shorthand for the obvious truth that when the mortgagee uses the full amount of the debt to purchase the property from the borrower, the borrower's debt is satisfied. It does not answer the question of whether a claim remains against third parties. Under traditional contract and tort theory, the defrauding or breaching party is liable for those damages actually and proximately caused by the fraud or breach. And under the closing protection letter, the title insurer must indemnify losses that "arise out of" the covered fraud or breach. The question in this case, then, should be whether Bank of America's claimed losses were proximately caused by, or arise out of, the fraud or breach under the well-established common-law standards. The Court of Appeals never engaged in that analysis. For that reason, this Court should reverse on this issue and remand for a proper analysis under the common law.

STATEMENT OF FACTS

Bank of America has provided a detailed, accurate, and well-supported explanation of the closing agent's role in the loan origination on pages 24–28 of its principal brief. The following discussion places that information, along with a discussion of foreclosure below, in the broader legal context that drives those lending practices.

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The closing is the final phase—and a critical one—in the loan's origination, because of the doctrine of merger. "Under this doctrine, the delivery and acceptance of a deed or execution of a lease, mortgage, or land contract is viewed as the final expression of the parties' intentions with respect to the transaction, even if the documentation is inconsistent with the parties' preliminary agreement." Cameron, *Michigan Real Property Law* § 17.7 (3d ed, 2005). Accordingly, at a proper closing, the lender appoints an agent to protect its interests in the transaction—someone responsible for confirming that the lender's conditions for issuing the loan are satisfied before the funds are disbursed and the mortgage is signed. This is the closing agent.

To ensure the lender's conditions are met, the lender issues closing instructions to the closing agent, which the closing agent agrees to follow if it proceeds with the transaction. While these instructions vary from transaction to transaction and from lender to lender, the purpose in every case is to protect the lender. Generally speaking, the closing instructions detail the closing agent's responsibilities to the lender, including specific steps that must be taken to confirm that the preconditions for the loan are satisfied. If the preconditions are not satisfied, the closing agent may not disburse the loan proceeds. See, e.g., Closing Instructions to Westminster, App 296, 300.

To protect the value of its mortgage lien, the lender also purchases a lender's title insurance policy. Title insurance shifts the risk of any covered defects in title to the title insurer and insures the priority of the mortgage. In this case, as in most cases, Bank of America also requested closing protection letters from the title insurer (First American), through its title agencies (Westminster and Patriot), who also happened to be serving as the bank's closing agent. As in this case, these standardized indemnity agreements recite the specific conditions under which title insurers (not the title agencies/closing agents) will accept liability for the acts or omissions of the closing agent in the handling of the bank's funds and certain other tasks for the specific transaction in which they are issued. See, e.g., Closing Protection Letter, App 274–275.

If the transaction closes, the loan is disbursed and the lender in exchange receives a mortgage on the real estate and a promissory note from the borrower. If the borrower then later defaults on the loan, the lender may obtain repayment through several mechanisms, including legal action on the note; but the primary remedy is foreclosure on the mortgage. Absent the borrower's cooperation, foreclosure is the only remedy that permits the mortgagee to resort to the property for repayment.

All mortgagees can foreclose through judicial action. And this is the preferred method of foreclosure when questions must be resolved regarding the priority of mortgages or title ownership. But the more common method of foreclosure is foreclosure by advertisement. The foreclosure-by-advertisement process is authorized and governed by statute. MCL 600.3201, *et seq.*; *Guardian Depositors Corp v Powers*, 296 Mich 553, 562–563; 296 NW 675 (1941). But only a mortgage providing the mortgagee with a contractual power of sale may foreclose by advertisement. *Cramer v Metro Sav & Loan Ass'n*, 401 Mich 252, 259; 258 NW2d 20 (1977). It is a contractual remedy. *Id*.

The culmination (but not the end) of the foreclosure process is the foreclosure sale. A deputy sheriff usually holds the sale at the circuit court in the county in which the property is located. Rarely does anyone other than the mortgagee bid at the foreclosure sale. In fact, other than the sheriff and the mortgagee's representative, typically no one else attends. Even the mortgagee may not attend the sale; many lenders instead mail in their bids to the sheriff.

Unlike disinterested third-party bidders, the lender in a foreclosure sale has something to lose if the property does not sell or sells below market value—it loses the value of its mortgage lien. To avoid this, mortgagees typically make a credit bid at the foreclosure sale with the debt they are owed. As the lower court explained in *New Freedom*, "[w]hen a lender bids at a foreclosure sale, it is not required to pay cash, but rather is permitted to make a credit bid because any cash tendered would be returned to it." 281 Mich App at 68. If the mortgagee purchases the property for less than market value, the borrower will be credited the property's full market value in any action for a deficiency judgment. MCL 600.3280. Because of this anti-deficiency defense, many lenders in Michigan have adopted the policy or practice of obtaining an appraisal shortly before the auction and bidding the property's fair market value, *up to* the full amount of the debt, i.e., a "full credit bid."

ARGUMENT

Two of the Court of Appeals' rulings in this case give the banking industry serious concern because of their detrimental impact on the well-established contractual relationships and remedies discussed above. First, the Court ruled that "to the extent a separate contract existed between Westminster and plaintiff that required Westminster to follow plaintiff's instructions, the contract was modified and limited by the [closing protection letter] to which the parties manifested their assent by proceeding with the closing." COA Op 15. Second, the Court held that the so-called "full credit bid rule" as a matter of law "barred" Bank of America's claims against third parties for fraud and breach of contract in the loan origination process. *Id*. at 13, 16. Because neither of these rulings comport with the common law or the foreclosure statute; they should be reversed.

I. First American's closing protection letter to Bank of America did not modify Bank of America's closing instructions to Westminster; they are separate contracts.

The Court of Appeals' ruling that First American's closing protection letter to Bank of America modified Bank of America's closing instructions to Westminster should be reversed. These were separate contracts—one instructing Westminster how to conduct the closing, the other establishing what losses First American would indemnify—and there is no manifestation of Bank of America's assent to modify its instructions to Westminster. Contrary to the unexplained holding of the Court of Appeals, there is no basis to construe the closing protection letter as modifying the closing instructions contract between Bank of America and Westminster.

"A meeting of the minds is required not only to make a contract but, also, to rescind or modify it after it has been made." *Universal Leaseway Sys, Inc v Herrud & Co*, 366 Mich 473, 478; 115 NW2d 294 (1962). "[T]he parties possess, and never cease to possess, the freedom to contract even after the original contract has been executed." *Quality Prods & Concepts Co v Nagel Precision, Inc*, 469 Mich 362, 372; 666 NW2d 251 (2003). But, as with all contracts, a modification must involve the parties' mutual assent. *Id*. at 373. "The mutuality requirement is satisfied where a modification is established through clear and convincing evidence of a written agreement, oral agreement, or affirmative conduct establishing mutual agreement to waive the terms of the original contract." *Id*. Here, there is no such evidence of mutual agreement between Bank of America and Westminster to modify the closing instructions or limit Westminster's liability.

Westminster does not dispute that the closing instructions form an agreement between Bank of America and Westminster as to how Westminster will conduct the closing on Bank of America's behalf before it disburses the funds. (Westminster's Appellee Br 25.) The closing instructions for the Enid property, for instance, are addressed to Westminster and state that "you are liable for any loss resulting from your failure to follow these instructions." See App 249. And they place conditions on disbursement of the funds, an act only Bank of America's closing agent could perform. Westminster demonstrated its agreement to performing this function of closing agent by disbursing the funds and certifying compliance with the closing instructions. See App 296. It is liable for any failure to perform the instructions.

The closing protection letter, on the other hand, is an agreement between First American and Bank of America, not Westminster. For instance, with respect to the Enid Property, First American's letter states that "the Company [First American], subject to the Conditions and Exclusions set forth below, hereby agrees to reimburse you [Bank of America] for actual loss incurred by you in connection with such closings when conducted by the Issuing Agent." The letter only identifies Westminster as the issuing agent. Though the closing protection letter states "[t]he Company will not be liable to you for loss arising out of" certain enumerated misconduct by Westminster, it does not say that *Westminster* will not be liable. Accepting First American's disclaimer of liability does not in any way manifest Bank of America's assent to release Westminster of liability or to modify Bank of America's closing instructions to Westminster.

Bank of America's closing instructions to Westminster and First American's closing protection letters to Bank of America are separate contracts that impose different obligations on different parties. The closing instructions impose certain obligations on Westminster and the closing protection letters impose other obligations on First American. One binds and creates liability for the closing agent, the other binds and creates liability for the title insurer. Neither one purports to limit Westminster's liability to the liability assumed by First American. The Court of Appeals erred in concluding otherwise and should be reversed.

II. Courts should apply the common law of damages; not a per se rule that no fraud or contract claim can ever be brought.

This Court should also reject the Court of Appeals' use of the "full credit bid rule" as a "bar" to Bank of America's common-law claims for damages. The so-called "full credit bid rule" is not a legal bar, nor is it a substitute for the traditional common-law damages analysis. It is merely shorthand for the truth that a borrower owes nothing more when it receives full credit for its debt at the foreclosure sale—the borrower's liability on the debt is satisfied. However, when the borrower's liability on the debt is satisfied through a full credit bid at the foreclosure sale, that does not mean that under no circumstances could a mortgagee ever show that losses proximately caused by the alleged fraud or breach of a third-party during loan origination or administration. This issue of causation should not be resolved with a per se rule but by application of the common law of contract and tort. Otherwise, an injustice would result in cases where the bank could satisfy the elements for a common law breach-of-contract or fraud claim but is nevertheless legally barred from pursuing the claim. Because the lower courts did not adjudicate the common-law element of causation, this Court should reverse.

A. At common law, Bank of America is entitled to be made whole for losses proximately caused by Defendants' breach or wrongdoing.

Bank of America has brought three distinct categories of common-law claims: breach-of-contract claims against Westminster and Patriot under the closing instructions, tort claims against Westminster and Patriot for fraud, and claims for indemnity from First American under the closing protection letter. Each of these categories of claims comes with its own standard for determining causation. The common law provides well-established rules for determining which losses are recoverable under each of these claims and which are not.

In the common law of contracts, Bank of America can recover not only the loss that "naturally results as the ordinary consequence the breach," but also that which "may, under the circumstances of entering into the contract, be presumed to have been in the contemplation of both parties as the probable result of a breach." *McConnell v US Express Co*, 179 Mich 522, 540; 146 NW 428 (1914); accord *Miholevich v Mid-W Mut Auto Ins Co*, 261 Mich 495, 498; 246 NW 202 (1933). Losses are presumed to be within the contemplation of the parties if they are the probable result of special circumstances known to the breaching party when entering into the contract. *McConnell*, 179 Mich at 535.

In the common law of torts, the standard is slightly different.

> [T]he wrongdoer is liable for all injuries resulting directly from the wrongful acts, whether they could or could not have been foreseen by him, provided the particular damages in respect to which he proceeds are the legal and natural consequences of the wrongful act imputed to the defendant, and are such as, according to common experience and the usual course of events, might reasonably have been anticipated. [*Van Keulen & Winchester Lumber Co v Manistee & NER Co*, 222 Mich 682, 687; 193 NW 289 (1923).]

As for the indemnity claim, the recoverable losses are determined by the terms of the indemnity agreement itself. In that contract, First American agreed to reimburse Bank of America for "actual losses" that "arise out of" Westminster's or Patriot's fraud or dishonesty. "Something that 'aris[es] out of,' or springs from or results from something else, has a connective relationship, a cause and effect relationship, of more than an incidental sort with the event out of which it has arisen." *People v Johnson*, 474 Mich 96, 101; 712 NW2d 703 (2006) (emphasis added); accord *Pac Emp'rs Ins v Mich Mut Ins*, 452 Mich 218, 225; 549 NW2d 872 (1996). This last standard is perhaps the least difficult to satisfy.

For instance, in *Pacific Employers*, this Court held that a 5-year-old child's permanent and disabling injuries from being hit by a car as she attempted to cross the road "arose out of" the bus driver's negligent use of the school bus—even though she was hit after walking half a mile away from where the bus driver dropped her off. 452 Mich 218. The bus driver was furnished a list of students and locations where they were to be dropped off, and the child at issue wore a tag on her clothes showing where she was to be dropped off. *Id*. at 220–221. But the bus driver dropped the child off at the wrong location. *Id*. In an effort to reach the babysitter's house on her own, the child walked half a mile down the road, then attempted to cross the street, when she was struck by an oncoming car. *Id*. This Court held that her injuries had more than an "incidental, fortuitous, or but for" causal connection to the bus driver's negligent use of the bus. "The injuries that followed were foreseeably identifiable with the negligent decision to disembark the child at the wrong bus stop." *Id*. at 224.

Bank of America should have been entitled to make its case under the above standards. If Bank of America can show that it suffered losses proximately caused by or arising out of third-party fraud or breach of contract in the closing or administration of the loans, then there is no sound legal reason to deny Bank of America recovery of those losses.

B. The full credit bid rule is merely a recognition that a full credit bid satisfies the borrower's liability for the debt; it does not resolve whether a third-party's fraud or breach proximately caused a lender to suffer losses.

Instead of applying the age-old common-law principles above, the Court of Appeals relied upon *New Freedom Mortgage Corp v Globe Mortgage Corp*, 281 Mich App 63; 761 NW2d 832 (2008), to hold that Bank of America's "full credit bid" bars any fraud or breach-of-contract claim against the third-party defendant closing agents or title insurer. The court has misunderstood the significance of the full credit bid rule, misapplying it here and in *New Freedom*.

The full credit bid rule is not a legal "bar" to any claim, such as the doctrine of res judicata or a statute of limitation. It is merely shorthand for the proposition that when the mortgagee uses the entire amount of the debt to purchase the property in a foreclosure sale, the borrower's liability for the debt is satisfied; it was spent to acquire the borrower's property at the foreclosure sale. See *New Freedom*, 281 Mich App at 68. The consequence of a full credit bid at a foreclosure sale is to extinguish the borrower's liability for the debt—nothing more and nothing less. The bank merely has credited the borrower what is owed rather than paid cash to purchase the borrower's property. When the bank successfully bids the amount it is owed on a secured loan at a foreclosure sale, the borrower no longer owes any money on the loan, leaving no claim for deficiency against the borrower. *Id*. On this point, *New Freedom* is accurate.

Where the Court of Appeals erred, in this case and *New Freedom*, is in treating the full credit bid as a bar to all further legal action against third-parties alleged to have committed fraud or breach of contract. Though crediting the borrower what he owes extinguishes the bank's claim against the borrower for repayment of the debt, this so-called "rule" is not, and should not be transformed into, a per se rule barring any and all actions by the foreclosing bank against third parties for fraud or other actionable conduct in the origination or administration of the loan. If, in the process of enforcing its rights under the loan documents through foreclosure or otherwise, the lender has not been made whole—or if the lender has suffered other losses arising from the origination or administration of the loan—then the lender should be allowed to sue third-parties for breach of contract or fraud, and the lender should be allowed to recover if it can prove the elements of its claims, including causation. That a full credit bid has eliminated the borrower's liability for the debt should not bar to the lender from recovering damages from third-parties for conduct causing the lender to have suffered losses..

New Freedom is flawed in many respects, but even that case acknowledges this important point above. Though it held the borrower's liability for debt was satisfied by a full credit bid, the court there still considered whether the third-party's wrongdoing or breach caused the bank any losses. *New Freedom*, 281 Mich App at 76. The error lay in its presumption that the bank's "damages were a direct result of IFC's full credit bid *and there [was] no evidence* that IFC's decision to make the full credit bid arose out of Welch's acts or omissions." *Id.* To the contrary, a bank's credit to the borrower does not in reality cause the bank to lose anything but its deficiency claim against the borrower. Title agents or other third-parties receive no credit toward their liability, as they are not parties to the statutory foreclosure process.

Foreclosure is a remedy against the borrower. *Cramer*, 401 Mich at 259; *Mich Ins Co v Brown*, 11 Mich 265, 272 (1863). It is not a remedy against third-parties alleged to have committed a tort or breached a contract. This remedial process achieves only one of two remedial outcomes: either (a) the bank receives money from a purchaser at the foreclosure sale or (b) the bank receives title to the property through making a credit bid at the foreclosure sale. In either case, the bank may or may not retain a deficiency claim against the borrower. But that has no bearing on whether a claim remains against third parties or whether damages remain from inducing the bank to issue an under-collateralized loan to an unworthy borrower.

The purpose of awarding damages in a contract or tort action is to make the injured party whole. *Corl v Huron Castings, Inc*, 450 Mich 620, 626; 544 NW2d 278 (1996) (holding that damages are awarded "to place the nonbreaching party in as good a position as if the contract had been fully performed."); *McAuley v Gen Motors Corp*, 457 Mich 513, 520; 578 NW2d 282 (1998). If the foreclosure process does not ultimately put the bank in the same position it would have been in but for the fraud or breach, then the bank is not made whole. See, e.g., *Corl*, 450 Mich at 626 (holding that damages are awarded "to place the nonbreaching party in as good a position as if the contract had been fully performed"); *D'Alessandro v Hooning*, 365 Mich 66, 73, 75–76; 112 NW2d 114 (1961) (holding that damages from a misrepresentation of the value of property are measured by the difference between the actual value and the value the property would have had if the statements had been true).

As against a third-party, for the bank to be made whole through the foreclosure process, it must receive value equivalent to what it would have received but for the third-party's fraud or breach of contract. The value actually received in that process is either money from a third-party purchaser or title to the property. If either one is insufficient to place the bank in the position it would have been in but for the fraud or breach, then a claim for damages should remain against the breaching or defrauding third party. See *Great N Packaging, Inc v Gen Tire & Rubber Co*, 154 Mich App 777, 786; 399 NW2d 408 (1986) (discussing offset of a damages claim at common law).

Assuming Bank of America demonstrates that a genuine issue of material fact exists on the other elements of its claims, the issues of causation and damages must be analyzed as well. The court should not reject Bank of America's claims on the sole basis that it submitted a "full credit bid." There is no need and no justification for a per se legal bar to any and all legal claims when the well-established common law is perfectly adequate to resolve those claims on a case-by-case basis.

CONCLUSION AND REQUESTED RELIEF

For the reasons given above, the MBA respectfully requests that the Court hold that Bank of America's closing instructions to Westminster constitute a separate contract from First American's closing protection letter to Bank of America, and reverse the Court of Appeals' ruling that the closing protection letters modified those instructions. The MBA further requests that the Court reverse the Court of Appeals' misapplication of the "full credit bid" as a per se legal bar and instead hold that the same common-law causation analysis that generally applies to every other contract and tort claim in Michigan also applies here.

Respectfully submitted,

Dated: April 15, 2015

WARNER NORCROSS & JUDD LLP

By *<u>/s/ Gaëtan Gerville-Réache</u>*

Gaëtan Gerville-Réache (P68718)
Rodney D. Martin (P32071)
900 Fifth Third Center
111 Lyon Street, N.W.
Grand Rapids, Michigan 49503-2487
616.752.2000
greache@wnj.com

Attorneys for *Amicus Curiae* Michigan Bankers Association

12434413